

Testimony of Professor Peter J. Henning
Before the House Committee on Ethics and Elections
On House Bill No. 4315
Tuesday, March 13, 2007

CHAIRMAN CORRIVEAU AND MEMBERS OF THE HOUSE COMMITTEE ON ETHICS AND ELECTIONS: My name is Peter J. Henning, and I am a Professor of Law at Wayne State University Law School in Detroit, Michigan. I teach courses in, among other things, Professional Responsibility & the Legal Profession and Corporations. In both of these areas of law, the issue of conflicts of interest plays a central role. I appreciate the opportunity to comment on House Bill No. 4315, which seeks to amend Michigan's conflict of interest statute.

Disclosure of Conflicts

Acting in one's self-interest is not necessarily wrong, except when a person is required to put the interests of another first. Conflicts of interest are viewed as problematic when a fiduciary responsibility is overridden by an effort at self-enrichment, even if the person owed the fiduciary obligation is not directly harmed. The usual remedy to prevent, or at least mitigate, the effect of a conflict of interest is to mandate full disclosure so that it is transparent that a person is acting in a way that might call into question whether the conduct fulfills the fiduciary obligation.

Michigan Business Corporation Act § 450.1545a(1) provides that if a director has an interest in a transaction, then it is not a violation of the director's fiduciary duty if the transaction is approved after full disclosure. Similarly, Michigan Rules of Professional Conduct 1.7 and 1.8 prohibit conflicts of interest unless the client approves after full disclosure and an opportunity to consult with independent counsel. In each area, disclosure is the preferred first means to

addressing any conflict issues, and each set of rules acknowledges that not every conflict of interest is disabling.

House Bill No. 4315 provides for a complete prohibition on voting if the legislator “has a substantial conflict of interest.” As an initial matter, there may be constitutional problems with this approach. Requiring the legislator to forego voting on a matter may effectively deny the legislator’s constituents their right of representation. While the prohibition may not be employed frequently, it could be that a matter of great concern to constituents will arise and their legislator is unable to vote because of the prohibition on voting if there is a personal conflict of interest. This approach could be troubling, particularly if the “substantial conflict of interest” requirement were to be read broadly.

The prohibition is also inconsistent with the approach in corporate law and in the legal profession, which allow for certain conflicts of interest so long as there is complete disclosure and approval. It may be that requiring a legislator to reveal a conflict of interest will have the same effect of limiting any ill effects or perceptions of impropriety as a prohibition. If a legislator’s conflicts are so severe that the person should not vote on a matter, but does so anyway, then the constituency of that legislator should be the ultimate judge of the propriety of the vote. Disclosure of the conflict would permit the voters, informed by the press and perhaps election opponents, to be the final arbiters.

Disclosure rather than a prohibition would allow for the legislator to vote on those matters in which a conflict, while present, would not be sufficient in the legislator’s eyes to affect the reasonable exercise of legislative judgment. This approach leaves the decision to the individual legislator, who would be required to disclose publicly the conflict if a vote is cast. If

the legislator concluded that the conflict was significant enough that a vote should not be cast, then recusal is an option. Under a disclosure approach, the legislator could – but need not – reveal the reason for not voting on the matter, so that possible embarrassment is avoided if the conflict is one that the legislator prefers not be made public. Requiring disclosure of a conflict if the legislator votes on the matter heightens transparency and allows for the voters to judge whether the person is acting appropriately.

Defining a Conflict of Interest

Perhaps the most difficult aspect of enacting rules on conflicts of interest is defining exactly what one is. Conflicts come in all different shapes, and in some instances may even exist only in the eye of the beholder. The focal point of most conflict of interest regimes is on personal financial conflicts, which can have a powerful effect on the exercise of discretion. Other types of conflicts are rooted in familial relations, competing fiduciary obligations, and the demands of differing constituencies.

House Bill No. 4315 addresses a range of possible conflicts in the definition of the operative phrase “substantial conflict of interest.” At the outset, I am not sure if the term “substantial” adds to the definition, and may even be a distraction. Simply determining whether there is a conflict of interest in a situation may be difficult enough, and then adding in “substantial” creates another layer of uncertainty, or perhaps even a loophole. The benefit of requiring that any conflict be substantial is to avoid trivial violations. If the definition is sufficiently broad without covering too many trivial instances, then adding “substantial” as a statutory term may not be necessary.

House Bill No. 4315 adopts a “reasonable person” standard, which I believe is the proper approach. An objective standard allows for a considered judgment without requiring a detailed inquiry into the individual’s state of mind. Similarly, the Bill’s definition of a conflict of interest includes the “appearance of impropriety” standard as one basis for finding a conflict, which I also support. Any provision limited to financial and familial conflicts will, almost by definition, be underinclusive by leaving out some circumstances that are clearly questionable but not at their core economic or involving a person’s relations. Again, using a reasonable person standard allows for a fair judgment to be made about whether a conflict appears to be present.

The current definition of a conflict of interest in House Bill No. 4315 is not easy to follow, and I think the language should be broken up into separate subsections to allow for more easy reference. Moreover, I believe “close economic association” may be too vague to define fairly what types of financial ties will trigger a conflict of interest. Attached to this statement, as Appendix A, is a draft of language that may provide a workable definition that includes a description of the familial relationships that can be the basis of a conflict of interest. The language is based on the conflict of interest provision in the ABA Model Business Corporation Act. I believe any definition should include situations in which there is indirect ownership through a family member or by an entity, such as a holding company or limited liability partnership, that has substantial control of a business.

House Bill No. 4315 applies to a “vote on a bill.” It is not clear whether this is limited to votes in the legislature, or if it also includes votes in a committee, so adding to the language some statement on the scope of the law’s application may address a potential gray area. The focus on voting and not other areas of legislative work provides a reasonable approach to the

issue because a vote is easily verifiable in most instances and provides a bright-line event that will trigger the statute. While a legislator may be able to take action to prevent a bill on which the person has a conflict of interest from even being considered, extending the conflict of interest rule to that situation might create significant problems regarding how far the provision should extend to other types of legislative work.

The proposal in Appendix A includes disclosure as the requirement if there is a conflict of interest. One issue the Committee may wish to consider is providing some type of advisory service to legislators who have questions about conflicts of interest. Any provision in this area will generate questions, and it would be good to have an avenue in which questions about conflicts can be answered, or at least discussed, in advance of a vote. The goal of full disclosure should provide a means for a legislator to act in good faith in seeking guidance and then making a decision about whether to vote.

If such a service is not currently available to legislators, I recommend that the Legislature explore creating an ethics advisory committee that can try to answer questions for legislators. The Michigan State Bar provides an ethics hotline through which attorneys can get answers to questions about their obligations under the Michigan Rules of Professional Conduct in a timely manner. Perhaps a similar model could be followed that would allow legislators to confidentially ask a non-partisan group for guidance on a conflict of interest issue.

I appreciate the opportunity to present my views to the Committee. I am happy to answer any questions you might have and provide any assistance in the future to the Committee or any Member of the Legislature on this issue. Thank you.

Appendix A

(2) A legislator shall disclose on the record any conflict of interest related to a bill prior to any vote, whether in committee or in the legislature, if the legislator votes on the matter.

(3) As used in this act:

(a) "Legislator" means a member of the legislature.

(b) "Conflict of interest" means:

(I) a financial interest, whether through direct ownership or through a related person or controlled entity, in an official action or decision that would reasonably be expected to impair the objective independent judgment of the legislator; or

(II) circumstances that a reasonable person would believe creates the appearance that the legislator or a related person may otherwise receive favored treatment regarding a public action.

Conflict of interest does not include a contract arising out of the status of being a student at a state institution of higher education authorized by Section 5 or 6 of Article VIII of the State Constitution of 1963 if the student is elected or appointed to the governing board of the institution.

(c) "Related person" means a legislator's spouse, child, stepchild, grandchild, parent, step-parent, grandparent, sibling, step-sibling, half-sibling, aunt, uncle, niece or nephew (including their spouses), or an individual living in the same home as the legislator.